Accountancy Board

2018 Annual Report

Annual Report 2018

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Accountancy Board
Quality Assurance

Annual Report 2018

The Accountancy Board presents its Annual Report for the year ended 31 December 2018 pursuant to Article 7(19) of the Accountancy Profession Act, Cap. 281of the Laws of Malta.

26 March 2019

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1. Chairman's Statement

In the past year, we proceeded with the regulation and oversight of accountancy practices in Malta in line with the requirements of the Accountancy Profession Act and related regulatory framework. In order to ensure the appropriate implementation of any required reforms, the Accountancy Board has also been in continuous contact with its various stakeholders, including the Maltese profession and its practitioners, other relevant regulatory entities and the various organs of the Committee of European Auditing Oversight Bodies.

Furthermore, this has also been the twelfth year of activities of the Quality Assurance Unit, which reports to the Accountancy Board through the Board's Quality Assurance Oversight Sub-committee. As may be seen throughout this Report, the year has also been a busy one for the Unit, which has also had both a new Head and administrator appointed. While the existing Unit team is well committed and dedicated to its work, the Board looks forward to the Unit being further consolidated with the additional human resources being envisaged.

The accountancy profession is a fast-expanding one within a constantly changing environment. Therefore, it is appropriate for all to keep in mind that ensuring both quality and regulatory compliance remains an essential pre-requisite for its continued progress.

Dr Peter Baldacchino Ph.D. (L'boro) M.Phil, FCCA, FIA, CPA
Chairman - Accountancy Board

26 March 2019

2. The Accountancy Board

Functions of the Board

The Accountancy Board regulates the accountancy profession in Malta and is entrusted with a number of functions, as outlined in Article 7 of the Accountancy Profession Act, including:

- the issue of accountants' warrants after making recommendations to the Minister for Finance;
- the issue of practising certificates in auditing;
- the registration of firms of accountants and auditors;
- keeping a register of the above;
- the operation of an appropriate system of quality assurance;
- dealing with cases of professional misconduct and other disciplinary proceedings;
- taking measures to protect the public interest and the integrity of the profession;
- advising or making recommendations and expressing its views to the Minister; and
- such other functions arising from any law or as may be delegated to it by the Minister under the Accountancy Profession Act.

Composition of the Board

Article 6(2) of the Accountancy Profession Act sets out that the Accountancy Board must be composed of:

- a chairman of recognised standing and experience in the accountancy and auditing profession;
- a member from a list of two nominated by the University of Malta from among the teaching staff of the Faculty or Faculties in which teaching of and research in the field of accountancy and auditing is organised;
- a senior official of the Ministry responsible for finance;
- two members from a list of four nominated by a recognised accountancy body; and
- two other members.

The Board was re-constituted on the 19th April 2017 for a period of two years. The following are the individuals who acted as Accountancy Board members during 2018:

Chairman
Dr Peter Baldacchino Ph.D. (L'boro) M.Phil, FCCA, FIA, CPA

Secretary
Mr Martin Spiteri IEng, MIIE, MBA (Leicester)

Members
Ms Christine Bartolo Perici, B.Com (Hons) Econ, MA Econ
Dr Desiree Cassar BA, LLD, Dip.Tax (up to the 27th May 2018)
Mr Mario P. Galea FCCA, FIA, CPA
Mr Paul Grech BA (Hons) Accty, FIA, CPA
Mr Benjamin Rizzo ACMA, FIA, CPA
Mr John Sammut MA (Fin. Serv.), BA (Hons) Accty, ACIB, CPA, FIA
Ms Denise Vella B.A. M.A. (Econ.) (appointed on the 28th May 2018)

Structure

The Accountancy Board has set up a number of committees and sub-committees to assist it in its various functions, as follows:

- The Investigative Sub-Committee;
- The Disciplinary Committee;
- The Quality Assurance Oversight Sub-Committee; and
- The Quality Assurance Unit.

The Investigative Sub-Committee

The Investigative Sub-Committee was set up to investigate cases, in the most part consisting of complaints, brought to the attention of the Board. This sub-committee, based on its assessment of the cases presented, then provides advice to the Board on whether it should refer the particular cases to the Disciplinary Committee. During the year, Mr Mario Galea chaired this sub-committee.

The Disciplinary Committee

The Disciplinary Committee acts on behalf of the Board in respect of cases of professional misconduct and other disciplinary proceedings. These proceedings may lead to the suspension or withdrawal of any warrant or practising certificate issued under the Accountancy Profession Act. The Disciplinary Committee is set up on an ad hoc basis and during the year, disciplinary proceedings were underway in respect to one statutory auditor providing audit services. Mr Benjamin Rizzo chaired this Disciplinary Committee.

The Quality Assurance Oversight Sub-Committee

Because of the changes to the Audit Directive, which came into effect during 2016, the quality assurance function now falls directly under the remit of the Accountancy Board, which is solely composed of non-practitioners. To assist in this role, the Board has set up a Quality Assurance Oversight Sub-Committee which reports directly to the Board. This sub-committee carries out detailed reviews of quality assurance visit reports before providing its recommendations to the Board for their final approval. Dr Peter Baldacchino chaired this sub-committee.

The Quality Assurance Unit

The Quality Assurance Unit (QAU) is the Unit, which acts on behalf of the Accountancy Board in the implementation, and supervision of the quality assurance process as contemplated in the provisions set out in Directive 4 to the Accountancy Profession Act. The quality assurance process is intended to be the means through which the Board provides assurance as to the quality of the professional work of statutory auditors and statutory audit firms and on the maintenance of appropriate levels of professional standards. The QAU conducts visits to statutory auditors and statutory audit firms. Ms Karen Sultana is the Head of this Unit.

Meetings

During 2018, the Accountancy Board met seven times. These meetings were held during January, March, April, May, July, September and October.

The committee and sub-committee meetings held during 2018 were as follows:

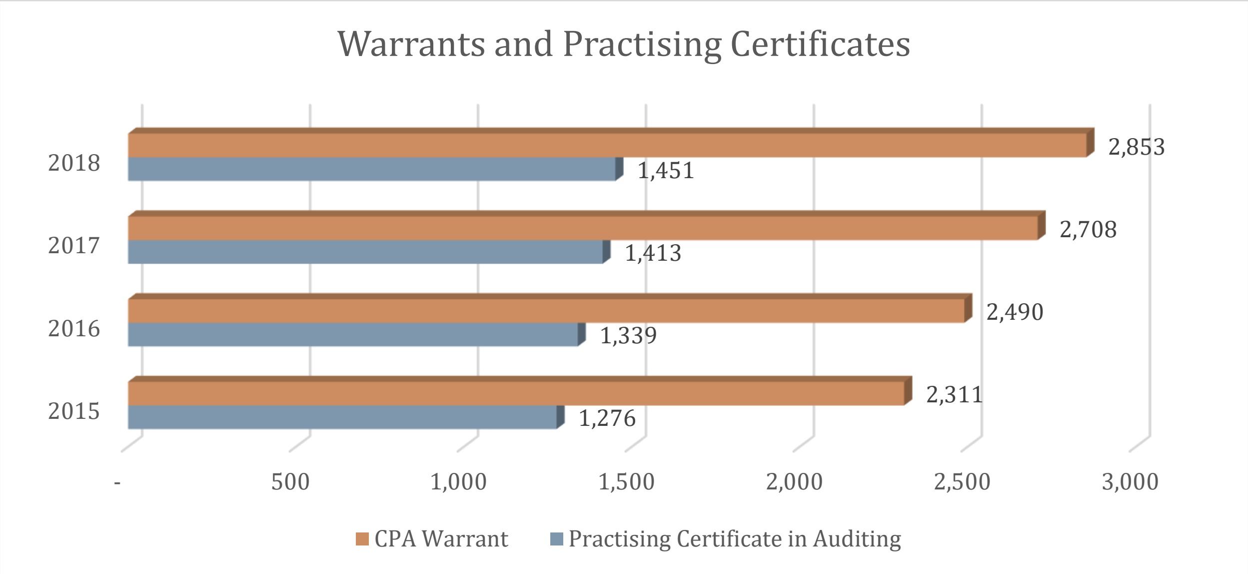
- The Investigative Sub-Committee met seven times;
- The Disciplinary Committee met two times; and
- The Quality Assurance Oversight Sub-Committee met nine times.

3. Profile of the Accountancy and Audit Profession

CPA Warrant Holders and Holders of a Practising Certificate in Auditing

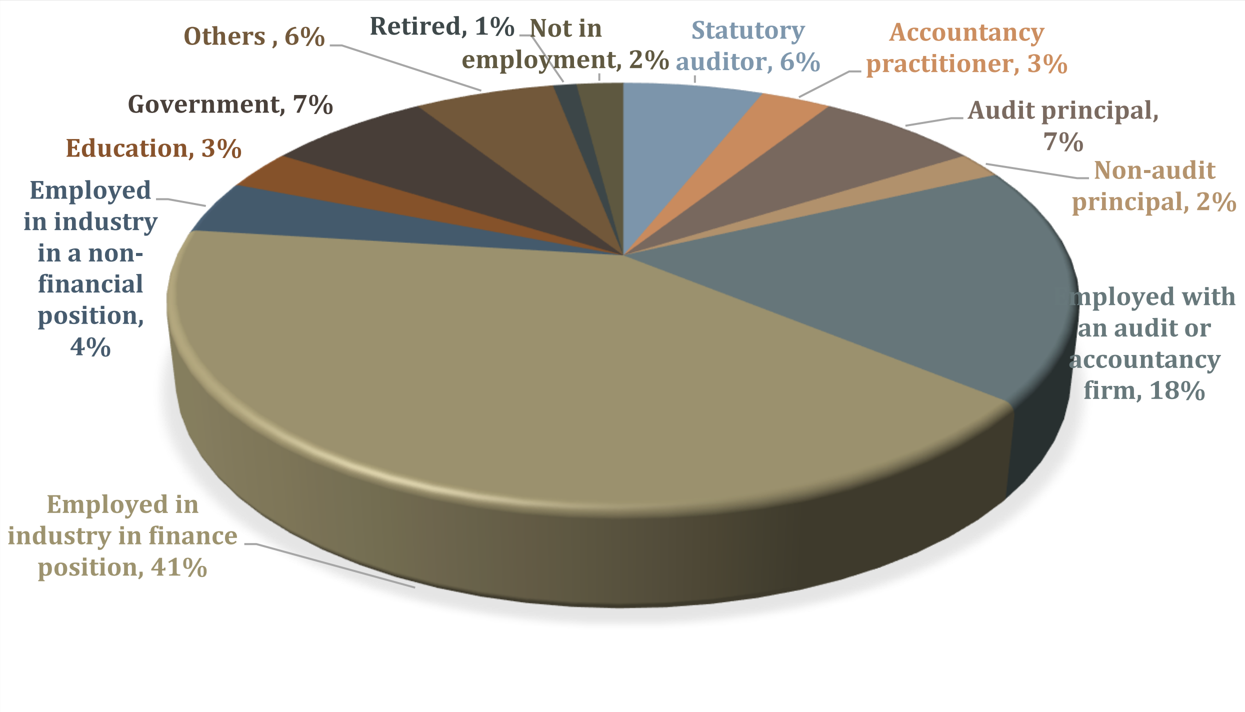
At year end, the total number of CPA warrant holders stood at 2,853 (2017: 2,708) whereas the total number of holders of a practising certificate in auditing as at 31 December 2018 amounted to 1,451 (2017: 1,413).

Year on year, the number of CPA warrant holders and holders of a practising certificate in auditing registered with the Accountancy Board is steadily increasing as can be seen below:

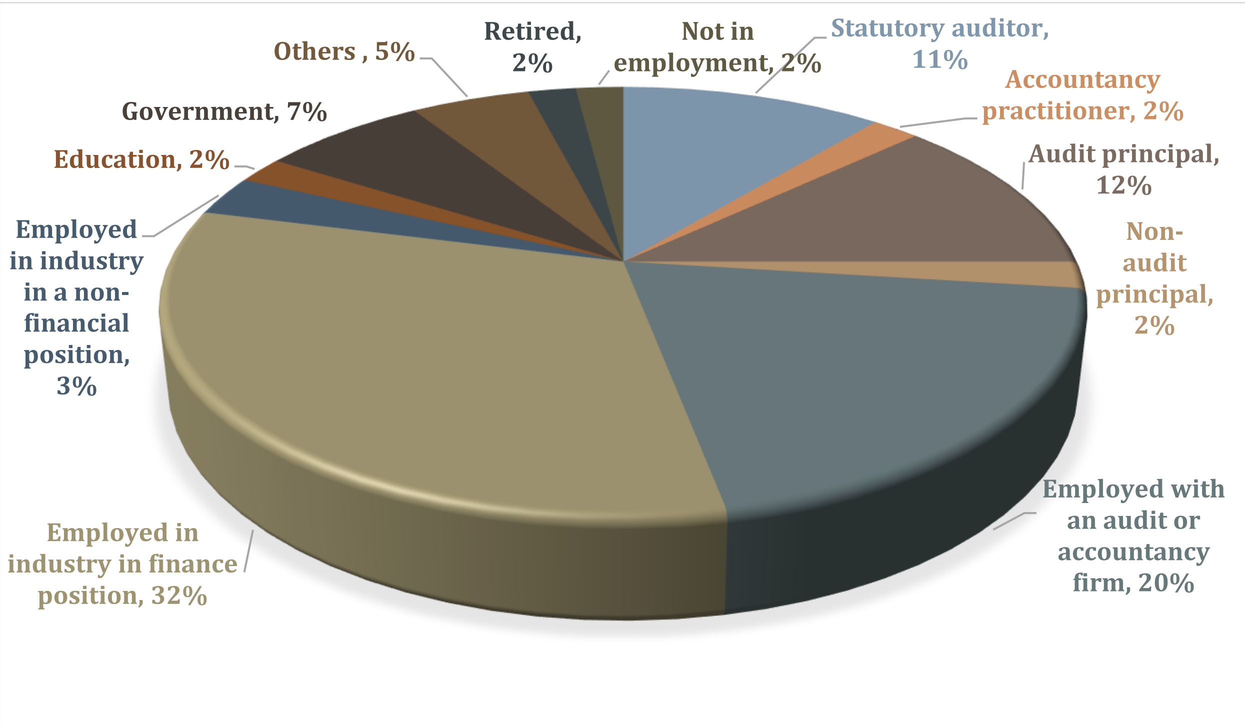


CPA warrant holders and practising certificate holders are availing of a number of different positions and opportunities both within the profession and outside the profession. This is represented in the below analysis which is based on submissions made by registered warrant holders and practising certificate holders through the annual return:

CPA warrant holders - Work Sector



Practising Certificate in Auditing - Work Sector



Sole Practitioners

At year end, the number of sole practitioners remained fairly static and totalled 256 (2017: 252). Of these, 168 (2017: 166) provided statutory audit services (94 operating on a full-time basis and 74 operating on a part-time basis) and the remaining 88 (44 operating on a full-time basis and 44 operating on a part-time basis) did not conduct audits [1].

Statutory Audit Practitioners – share of market

Based on declarations made through annual return submissions, it is noted that statutory audit practitioners account for approximately 38% of total audits engagements. In addition, one statutory audit practitioner also carries out the audit of a public interest entity which is listed on the Malta Stock Exchange.

Accountancy and Audit Firms

The Accountancy Board, apart from granting warrants and practising certificates in auditing to individuals, the Board also is responsible for registering accounting and audit firms. Accounting and audit firms may either be structured as a partnership, or else incorporated as a limited liability company. At 31st December 2018, the number of accounting and audit firms registered with the Accountancy Board stood as follows:

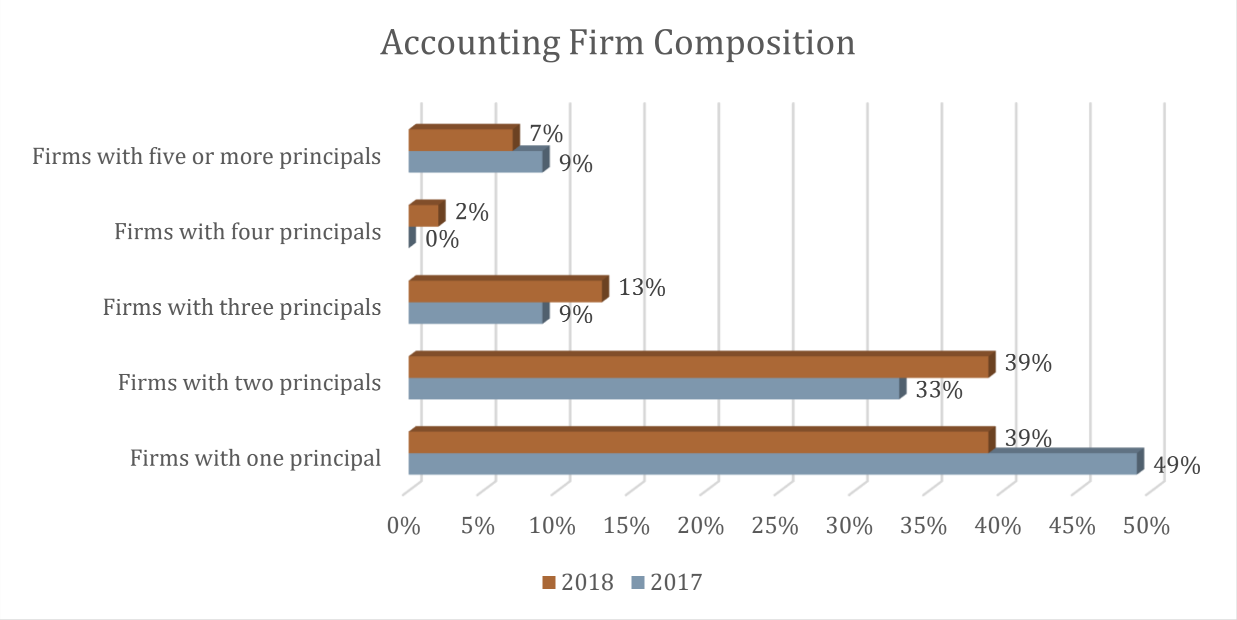
- 56 Accounting Firms (2017: 45); and
- 83 Audit Firms (2017: 78).

Accounting Firms

During the year, there was a marked increase of circa 24% in the number of accounting firms registered with the Board.

[1] This information is based on data extracted from 2018 Annual Returns submitted by 1 February 2019.

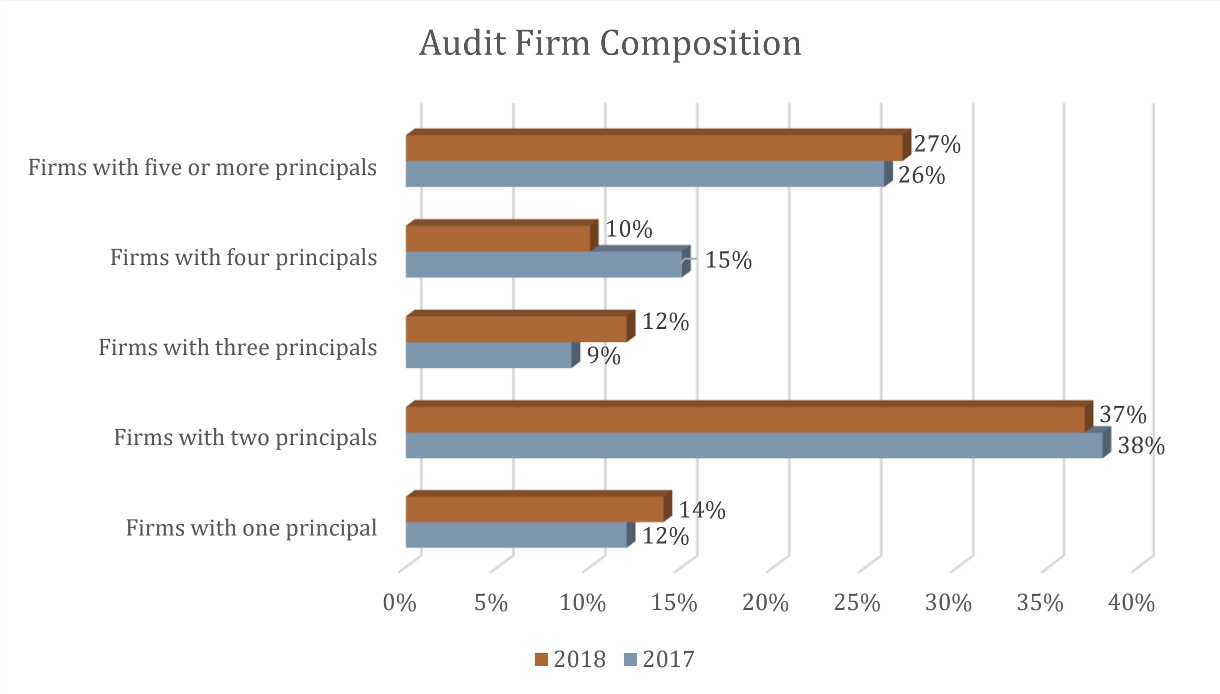
Furthermore, during the year, it was noted that whereas in 2017 accounting firms were primarily composed of one principal firms (49%), during 2018 the trend has shifted with 39% of accounting firms now being composed of one principal and another 39% of accounting firms having two principals. The below bar graph shows the composition of accounting firms during 2017 and 2018:



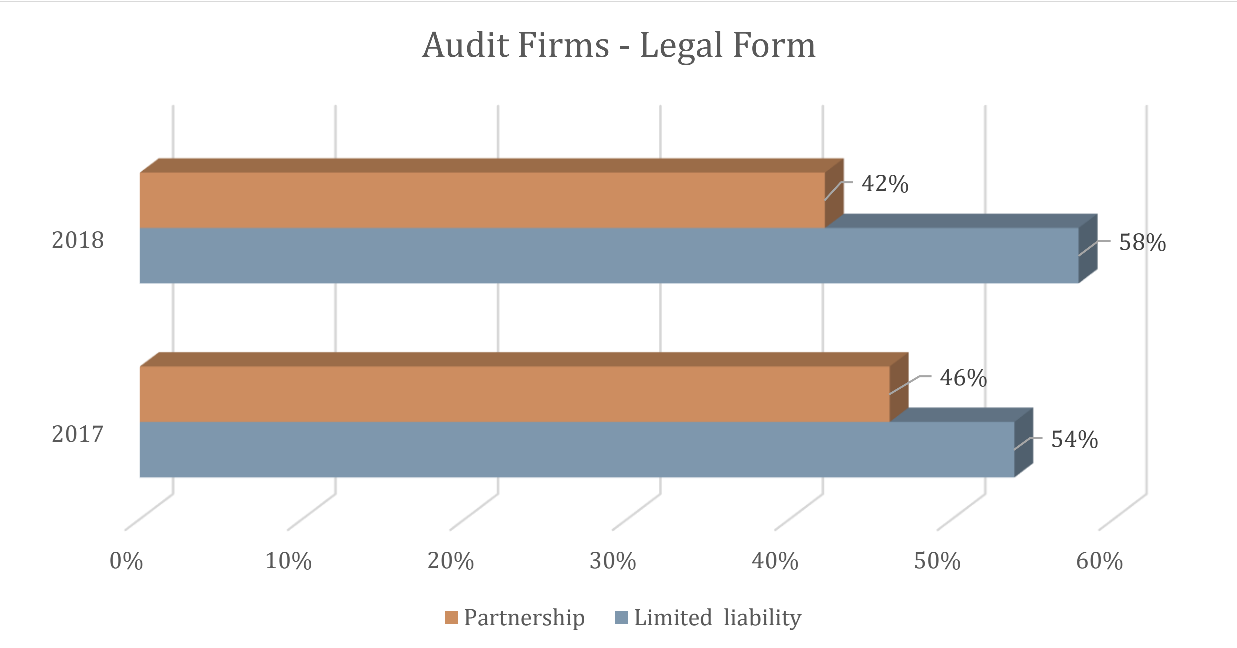
During both 2018 and 2017, in respect to the structure of firms it was noted that 98% of accounting firms were incorporated as limited liability companies, whilst the remaining 2% were registered as partnerships.

Audit Firms

At year end, there was an overall increase in the number of audit firms registered with the Accountancy Board of 6%. Similar to the prior year, most audit firms were composed of two principals. In respect to audit firms, the composition of principals in such firms has remained fairly consistent with that of the prior year, with no major shifts in the categories as indicated in the bar graph.



Although the composition of principals in audit firms has remained similar to that of the prior year, during 2018 the legal form of audit firms has changed, with 58% of audit firms now having a limited liability structure (as opposed to 54% in 2017). It was noted that new audit firms prefer to register as limited liability companies, whilst existing audit firms are also shifting to limited liability structures and de-registering existing partnerships.



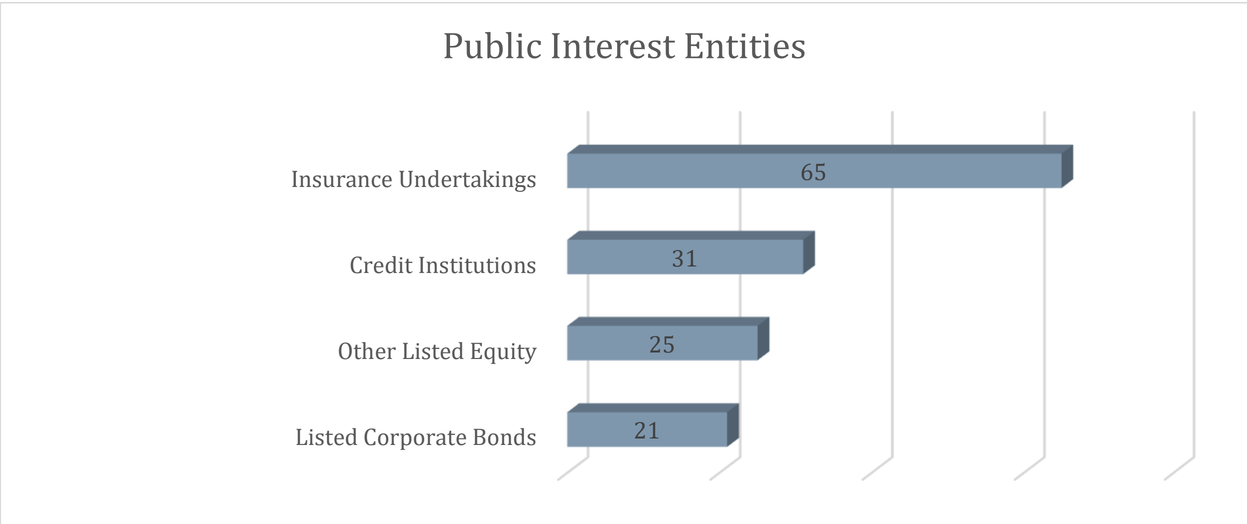
Statutory Audit Firms – share of market

In respect to audit firms, as declared in annual return submissions, such firms carry out approximately 62% of total audit engagements. Furthermore, the majority of PIE audits are carried out by some of these audit firms.

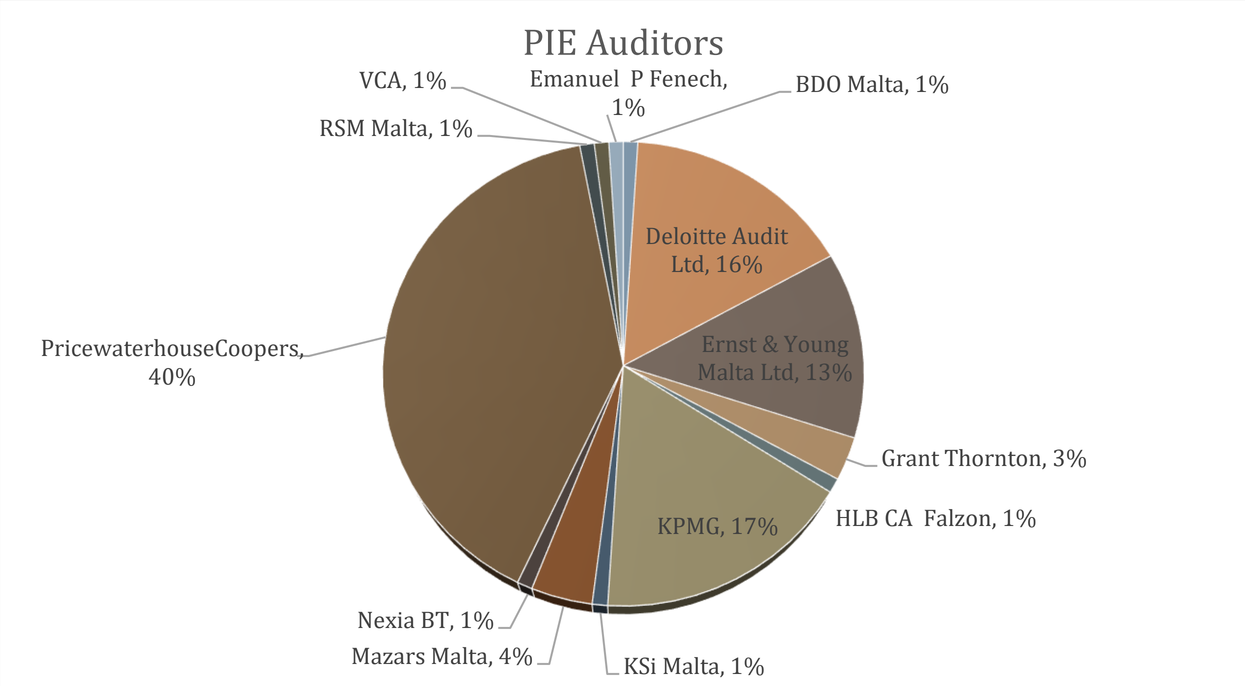
PIE Auditors

Public interest entities (PIEs) are entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC, a credit institution as defined in point 1 of Article 3(1) of Directive 2013/ 36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, other than those referred to in Article 2 of that Directive, an insurance undertaking within the meaning of Article 2(1) of Directive 91/674/EEC and such other entities as may be prescribed by the Minister responsible for Finance.

An illustrative segmentation of all types of entities which are deemed to be PIEs is noted below:



As at end of year, the number of audit firms and audit practitioners providing statutory audit services to PIEs stood at thirteen. Furthermore, 86% of all PIE audits are conducted by the Big 4 statutory audit firms. The remaining 14% of PIEs audits are carried out by mid-tier statutory audit firms and one sole practitioner providing audit services.


PIE Auditors
VCA, 1%
Emanuel P Fenech, 1%
BDO Malta, 1%
RSM Malta, 1%
Deloitte Audit Ltd, 16%
Ernst & Young Malta Ltd, 13%
PricewaterhouseCoopers, 40%
Grant Thornton, 3%
HLB CA Falzon, 1%
KPMG, 17%
Nexia BT, 1%
Mazars Malta, 4%
KSi Malta, 1%

4. The Quality Assurance Unit

The Unit

The Quality Assurance Unit (QAU) acts on behalf of the Accountancy Board in the implementation and supervision of the quality assurance oversight function as contemplated in the provisions set out in Directive 4, the Quality Assurance Directive.

The primary function of the QAU is that of carrying out monitoring visits to statutory auditors and firms providing statutory audit services and preparing reports on these inspections for consideration by the Board. The main objective of these monitoring visits is to ensure that all statutory auditors and firms maintain the highest level of professional standards and audit quality.

QAU Staff and Basis of Funding

The QAU staff complement at year end, was composed of a Head of Unit as well as three full-time reviewers. One of these reviewers assisted the unit in its administrative tasks.

In respect to funding, the Accountancy Board requires the settlement of an annual Quality Assurance Regulatory Fee from all statutory auditors and audit firms, as stipulated in Directive 4 of the Accountancy Profession Act. Furthermore, Directive 4 also outlines other fees that may be levied on statutory audit firms and statutory auditors. All such fees received by the QAU or Board are remitted to the Ministry for Finance. The Ministry then funds all expenses incurred by the Board and by the Quality Assurance Unit, in their entirety. This system of funding ensures that the Unit is free from undue influence by statutory auditors and audit firms.

The following is the QA Regulatory Fee structure for statutory auditors and statutory audit firms as set out in Directive 4 of the Accountancy Profession Act:

- Part-time sole practitioners €116
- Full-time sole practitioners €233
- Firms with one principal €233
- Firms with less than three but more than one principal €582
- Firms with less than five but more than two principals €1,630
- Firms with five or more principals €5,950

In the case of follow-up visits, when the Board sanctions these types of visits, an additional fee is charged in respect of such visits. The follow-up fee is calculated by multiplying the number of hours spent on the visit by a charge-out rate of €34.94 per man hour. Regulatory penalties may also be charged in respect to breaches as contemplated in Schedule 1 of Directive 4.

Training

The Board is committed towards ensuring competence of its staff members and as a result, a substantial number of CPE activities were attended during the course of the year. Reviewers are encouraged to attend courses both locally and abroad.

One such event, attended by the Head of the QAU and one reviewer, was organised by the CEAOB Inspections Sub-Group – Smaller Regulators Task Force and took place over two days in Berlin, Germany. This event dealt with inspections of banking and insurance entities.

Staff members are required to adhere to CPE requirements and keep abreast of changes occurring that impact the profession. By the end of 2018, all reviewers exceeded mandatory CPE requirements as set out in Directive 1 of the Accountancy Profession Act.

Training focused primarily on audit-related courses relevant to audit reviews however, courses in financial reporting, legislation and taxation were also attended, amongst others.

QAU Inspection Methodology

As in prior years, the QAU adopts a risk-based approach when carrying out monitoring visits to statutory auditors and audit firms, including the selection stage of statutory auditors and audit firms for review as well as throughout the visit itself from planning to completion.

In summary, the monitoring visit process can be divided into three stages as follows:

Stage 1 - PLANNING

(a) REVIEW OF DOCUMENTATION

- Annual return
- Forms 1,2,3
- Audit client list
- Transparency report (PIE auditors)
- Prior QAU report

(b) IDENTIFICATION OF RISK AREAS

(c) PLAN PROCEDURES TO ADDRESS RISKS

Stage 2 - FIELDWORK

(a) OPENING MEETING

(b) QUALITY CONTROL PROCEDURES REVIEW

-Letterheads; CPE;ISQC 1 & independence; PII; ACRs & cold file reviews; CAIM for PIE auditors

(c) AUDIT FILE REVIEWS

-Review of financial statements; Review of audit files; CAIM for PIE auditors

(d) REVIEW OF REPLIES RECEIVED & SUMMARY OF FINDINGS

(e) CLOSING MEETING

Stage 3 - COMPLETION

(a) REPORTING

-QAU drafts report based on findings & firm/practice responses

(b) APPROVAL

-QAOSC review of visit report

-Board approval of visit report

(c) ISSUANCE OF REPORT AND FOLLOW-UP

-Request confirmations & impose sanctions (if needed)

-Ensure that confirmations are received & sanctions addressed

Stage 1 Planning

Prior to the on-site inspection, a review is carried out of information available pertaining to the statutory auditor or firm. This information is obtained through documentation such as correspondence files, annual returns, forms requested on notification of the visit, previous visit reports, transparency reports and MFSA registry searches.

Based on the information obtained through the review of such documentation, the reviewer identifies the risks pertaining to the visit and plans procedures accordingly to address those risks.

Stage 2 Fieldwork

On the first day of the visit, the reviewer(s) hold an ‘opening meeting’ with the compliance principal, who is the individual appointed within a firm to address compliance related matters or in the case of the sole practitioner, the sole practitioner himself. The opening meeting with the compliance principal is utilised to discuss any potential risks that would have been identified during the planning stage. Furthermore, the purpose of the opening meeting is to identify other potential risks areas to focus on during the course of the fieldwork stage of the visit. During this meeting, other documentation will be provided, by the compliance principal, to the reviewer(s), such as the audit client list.

The objective of the visit is to carry out an assessment of compliance with applicable auditing standards and independence requirements, of the quantity and quality of resources spent and of the internal quality control system of the statutory auditor/firm, supported by adequate testing of audit files. To this effect, a general practice/firm review and audit file reviews are carried out.

The general practice/firm review entails a review of the quality controls of the statutory auditor/firm and a review of compliance with legislative requirements. Normally, a number of documents are requested from the compliance principal such as:

- the firm/practice professional indemnity insurance policy;
- CPE declarations pertaining to principals and staff;
- the practice or firm ISQC 1 manual;
- independence declarations of principals and staff;
- letterheads of the audit firm and/or practice as well as any connected undertakings; and
- the last two Audit Compliance Reviews as well as last cold file reviews.

In addition, on visits to PIE statutory auditors/firms, the Unit applies the Common Audit Inspection Methodology ('CAIM'). CAIM is an inspection programme introduced by the European Audit Inspection Group (EAIG) to ensure an effective and consistent inspection approach across regulators within the EU. On PIE auditor/audit firm visits, the compliance principal will be informed before the start of the visit, of the additional documentation required in respect to whole firm/practice procedures.

Apart from an assessment of the general practice/firm procedures, reviewers will also select one or more audit files for review. The number of files selected for review is at the discretion of the QAU. File selection is risk-based and depends on risk factors such as public interest, the size of audit clients and any audit qualifications, amongst others. Prior to the file review, the reviewer analyses risks relating to the audit client through a review of the audited financial statements. The reviewer would then assess how the statutory auditor/firm addressed those risks through the documentation found in the audit file.

Furthermore, when reviewing PIE audits, CAIM procedures addressing some audit specific related topics (i.e. revenue, group audits and estimates) will also be used in addition to other tailored templates adopted for such entities by the QAU reviewers.

During the course of the fieldwork, the compliance principal will be given a number of queries raised by the QAU for their comment. These queries will be based on the documentation and audit files reviewed during the course of the visit. On the basis of the replies received and evidence found on file, the QAU reviewer(s) will draft a summary of the findings which have not been resolved.

These findings are discussed with the compliance principal during the closing meeting. The statutory auditor or audit firm is then given fourteen days to reply to the issues raised and to identify how these issues will be addressed going forward.

Stage 3 Completion

Following the completion of the fieldwork part of the visit and on receipt of the statutory auditor's or audit firm's responses to the closing meeting document, a report is drawn on the findings identified during the visit and the conclusions of the quality assurance process in respect of the statutory auditor/firm, based on responses received from the compliance principal.

Reports are categorized for internal purposes into ratings which are determined by the instances and magnitude of non-compliance with the relevant regulations, the level of commitment and ability of the statutory firm/auditor to correct the problems identified and the regulatory action, if any, which should be applied.

The Head of the QAU will then present individual visit reports to the QAOSC for their review and approval. Subsequently, the QAOSC will refer these visit reports to the Accountancy Board for their final review and approval.

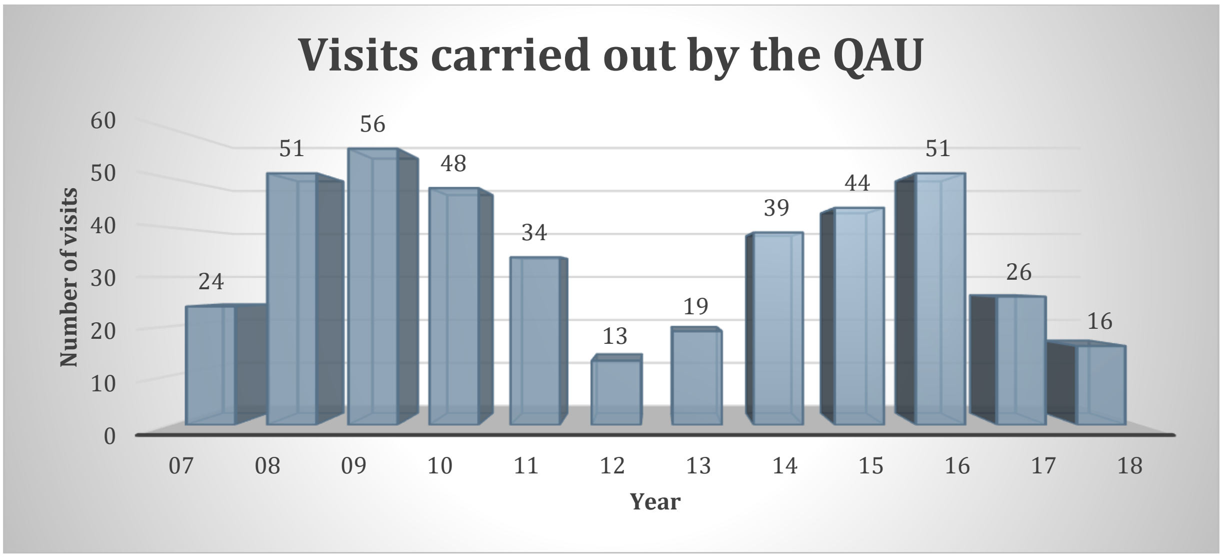
Based on the extent of the findings identified during the visit and the compliance principal's replies, the Board then would request confirmations from the statutory auditor/firm about actions expected to be taken by the statutory auditor/firm. Also, sanctions may be imposed, when necessary. Such confirmations and sanctions would be included in the closing down letter. The final report would also be sent with the closing down letter to the practitioner or audit firm.

The QAU then monitors that any required confirmations were provided by the compliance principal and will monitor that any sanctions imposed have been satisfactorily addressed. If the QAU has any concerns regarding the confirmations received or the results of the sanctions imposed, the statutory auditor or statutory audit firm will be referred to the Accountancy Board for further action.

Quality Assurance Visits

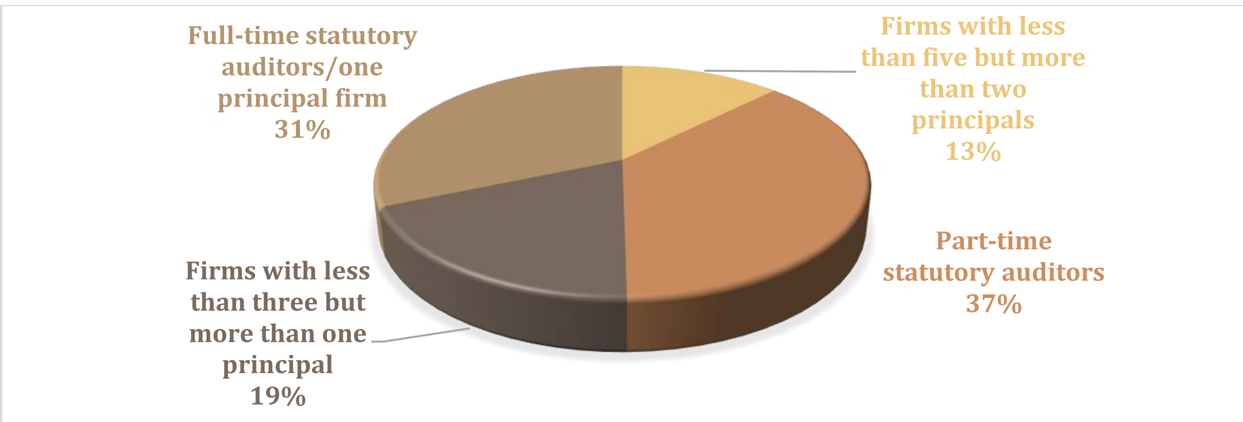
Quality assurance visits are carried out on the basis of an analysis of risk. Visits to PIE auditors and firms are carried out at least once every three years whilst visits to non-PIE statutory auditors and firms performing audits of entities under the European Union Law are carried out at least once every six years. Where audit quality issues are noted, follow-up visits (outside the normal visit cycles) are also carried out. These normally occur within nine months from the completion of the prior visit.

Over the period 2007 to year ended 2018, the QAU carried out a total of 421 quality assurance visits. Of these, 411 had been approved by the Board by the end of 2018. During 2018, the QAU continued the fourth visit cycle on PIE statutory auditors and firms. The QAU is now in its third cycle of visits for non-PIE statutory auditors and firms. The number of visits carried out by the QAU throughout the 12 year period from 2007 to 2018 is illustrated in the diagram below:



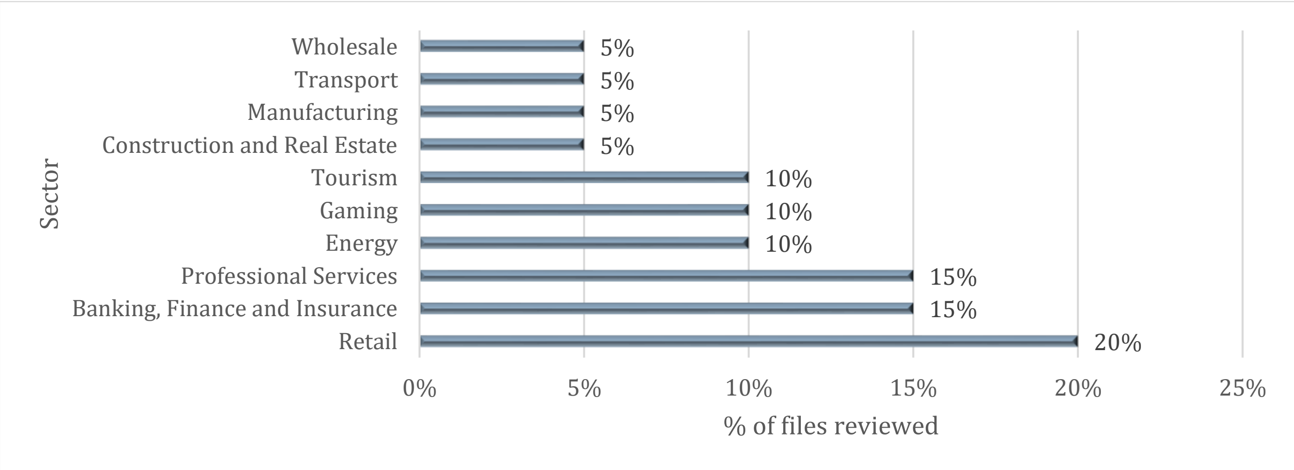
During the course of 2018, the QAU carried out a total of 16 visits (2017: 26), this includes one visit to a statutory audit practice carrying out audits of a public interest entity.

The following analysis depicts the composition of statutory auditors and firms reviewed during 2018 by the QAU:



During the year, four reports pertaining to visits carried out in 2017 were discussed and approved in 2018 (including the visit report of one PIE statutory audit firm). The main findings identified from visits approved by the Accountancy Board during 2018 are included in Section 5 of this report. At end of year, a total of ten reports (seven concluded visits and three visits which were still work-in progress at year end) still had to be approved by the Board (including two PIE statutory audit firm/practice reports). These visit reports will be discussed and presented to the Accountancy Board and Quality Assurance Oversight Sub-Committee, for their approval, during the early part of 2019.

During 2018, the Quality Assurance Oversight Sub-Committee and Accountancy Board reviewed eleven visit reports. During the course of these visits, a total of twenty audit files were reviewed by the QAU of which two pertained to public interest entities. An analysis of the audit files reviewed by industry sector by the QAU is shown below:



5. Overview of 2018 QAU Visits

Overview of Reports

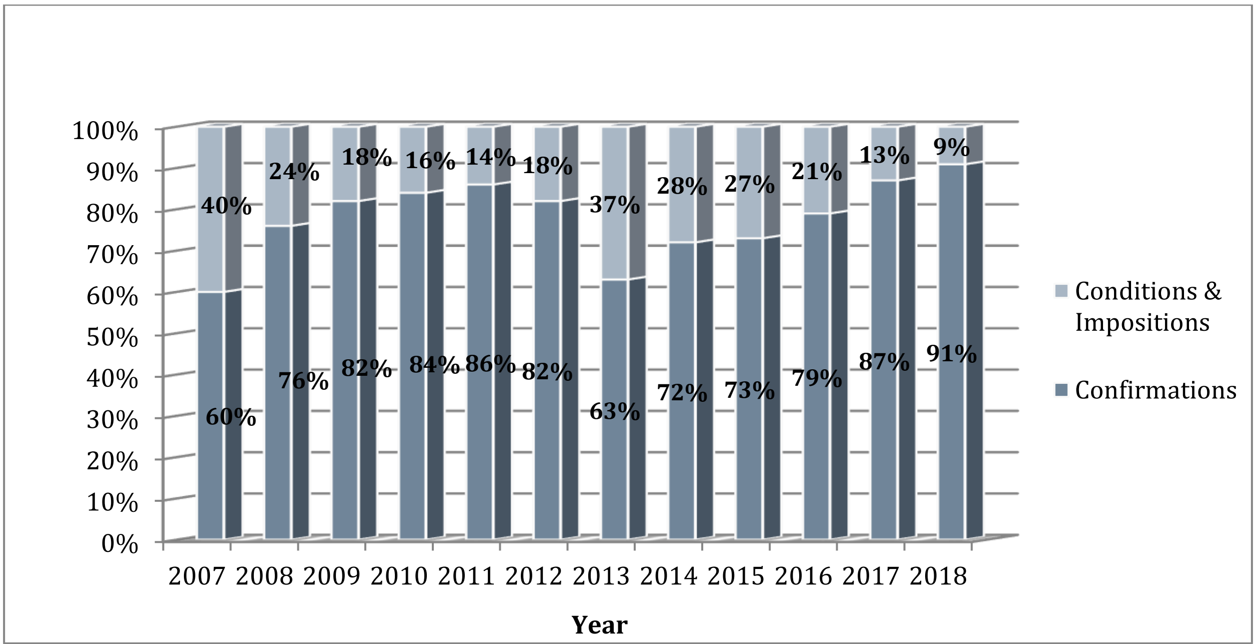
Subsequent to the completion of the QAU visit, issues arising are communicated to statutory auditors and audit firms in the form of a report. On the basis of the findings included in the Accountancy Board's Quality Assurance Visit Report, the Accountancy Board in its closing down letter to the statutory auditor or firm would inform them of any confirmations required. Furthermore, in some cases depending on the extent and gravity of the findings identified, further sanctions may be imposed on the statutory audit firm or auditor.

The Accountancy Board requests confirmations, in order to ensure the implementation of procedures to address matters raised during the QAU visit. Confirmations require statutory audit firms or statutory auditors to take action to address the findings identified. During subsequent visits, prior visit findings are reviewed to assess whether or not confirmations provided in the prior visit have subsequently been addressed. Should the statutory audit firm or statutory auditor fail to take timely action based on confirmations provided, this may lead to sanctions/conditions being imposed.

There are various types of conditions/sanctions which may be imposed at the end of a visit. Conditions include the imposition of follow-up visits, hot file restrictions, external audit compliance reviews and external cold file reviews. In some cases, depending on the gravity of the findings, audit firms or statutory auditors may be referred to the Accountancy Board for disciplinary action.

Up until the end of 2018, the Accountancy Board determined that only confirmations were required from statutory auditors/ audit firms on 91% of visits carried out (2017: 87%). On the other hand, confirmations as well as conditions were imposed on 9% of statutory auditors/audit firms visited in 2018 when compared to 13% in 2017. Furthermore, during the year, due to the fact that a statutory audit visit, carried out in prior years did not comply with the sanctions imposed by the Board, such statutory auditor was referred to the Disciplinary Committee during 2018.

However on a general basis, overall there was an improvement in the audit quality noted during the visits approved during the year. An analysis of the courses of action taken by the Board since 2007 is illustrated in the diagram below:



During 2018, the Accountancy Board imposed an external cold file review. No other sanctions were imposed during the year on visits that were approved in 2018.

The number of conditions imposed on statutory audit firms and statutory auditors since 2007 amounted to seventy-one. These can be analysed as follows:

	Follow-up visits	External ACRs and/or cold file reviews	Hot file restrictions	Other restrictions
PIE Statutory Audit Firms	3	0	1	0
Non-PIE Statutory Audit Firms	5	11	0	0
Full-Time Statutory Auditors	8	18	6	1
Part-Time Statutory Auditors	4	9	4	1
Total	**20**	**38**	**11**	**2**

Key Observations from 2018 Visit Findings

In this section of the report, the most common weaknesses that were noted, based on the findings identified from reports prepared following QAU visits and approved by the Board during 2018, will be identified and analysed.

Visits which have been carried out in 2018 by the QAU, but for which the Accountancy Board, for the scope of this assessment, has not yet approved, have not been included. However, the analysis includes findings identified during eleven visits (including a PIE statutory audit firm) which were approved by the Accountancy Board during 2018. Findings, as presented in the prior year, have been categorised as follows:

- At planning stage of the audit files reviewed;
- At audit fieldwork stage of the files reviewed;
- At audit completion and reporting stage of the files reviewed; and
- At statutory auditor/firm level.

An analysis of the planning issues raised on the files reviewed is presented in the diagram below:

Analysis of File Findings At Planning Stage	Statutory Audit Firms (percentage) 2018	Statutory Auditors (percentage) 2018	Total Average (percentage) 2018	Total Average (percentage) 2017
Laws and regulations	**25%**	**86%**	**64%**	26%
Independence considerations	**75%**	**29%**	**45%**	48%
Client acceptance and continuance	**75%**	**14%**	**36%**	35%
Terms of engagement	**25%**	**43%**	**36%**	23%
Risk assessment and identification	**50%**	**29%**	**36%**	16%
Knowledge of the company	**25%**	**43%**	**36%**	16%
Materiality	**50%**	**14%**	**27%**	55%
Going concern	**-**	**43%**	**27%**	29%
Related parties	**25%**	**29%**	**27%**	29%
Fraud	**25%**	**29%**	**27%**	10%

Laws and regulations – During the year, a marked increase in the findings noted, particularly in respect to visits to statutory audit practitioners, in relation to laws and regulations was identified at the planning stage. Auditors are reminded that in accordance with ISA 250, you are required to obtain a general understanding of both the legal and regulatory framework applicable to the audit client and the industry/sector in which the entity operates and understand how the audit client is complying with that framework. Furthermore, the auditor is required to obtain sufficient appropriate audit evidence regarding compliance with those laws and regulations that can have a direct effect on material amounts and disclosures in the financial statements being audited. The auditor is required to inquire with management and, where appropriate, those charged with governance if the company is in compliance with laws and regulations. The auditor is also required to inspect correspondence, if any is available, with licensing or regulatory authorities. All such considerations should be adequately and appropriately documented on file.

Independence considerations – Weaknesses noted in respect to independence continue to feature in a significant number of visit findings, particularly in relation to visits carried out on audit firms. Similar to the previous year, it was noted that although non-assurance services were provided in addition to the audit, or the audit practitioner or audit firm had been long associated with the audit client, independence considerations were either not sufficiently documented or not adequately addressed, by the adoption of adequate safeguards. Furthermore, in a number of instances, policies and procedures in respect to independence considerations documented by the practice/firm in their ISQC1 manual were not being addressed.

Practitioners and firms are required to identify and evaluate circumstances and relationships that create threats to independence, in line with the Code of Ethic requirements. They are also required to evaluate information on breaches of the practice's/firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement and to take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards or possibly withdrawing from the audit engagement.

Client acceptance and continuance – ISA 220 requires engagement partners to be satisfied that appropriate procedures regarding the acceptance and continuance of audit engagements have been followed and considered appropriate.

During the course of the year, on one particular visit, it was noted that documented ISQC 1 policies and procedures in respect to acceptance and continuance were not followed. Another visit identified that, on a particular audit engagement, no client acceptance and continuance procedures had been carried out. Furthermore, on another visit it was difficult to determine how the audit firm concluded that the client engagement should be continued as year on year audit qualifications continued to be unaddressed by the entity.

Terms of engagement – In accordance with ISA 210, the auditor is required to agree the terms of the audit engagement with management or those charged with governance, as appropriate. ISA 210 also identifies the relevant sections to be included in the letter of engagement. During one QAU visit it was noted that sections dealing with the objective and scope of the audit, as required by ISA 210 were not included. Furthermore, on another QAU visit, the practitioner had not issued an engagement letter to the audit client.

In addition, ISA 210 on recurring audits requires that the auditor assesses whether circumstances require the terms of engagement to be revised, and whether there is a need to remind the entity of the existing terms of engagement. During one QAU visit, the practitioner had last issued an engagement letter to the audit client, way back in 2011 and since had not considered revising this engagement letter. On another visit, the engagement letter referred to IFRS as the relevant accounting framework, when instead GAPSME should have been referred to.

Risk assessment and identification & knowledge of the company – In line with the requirements of ISA 315, the engagement team is required to carry out procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion level. Such procedures should include inquiries with management and others within the entity, analytical procedures as well as observation and inspection. Apart from this, the engagement principal will consider client acceptance and continuance procedures, prior knowledge of the client as well as factors identified on other engagements within the same group. These factors should be discussed internally within the engagement team.

Apart from the identification and assessment of risk, the auditor is also required to obtain an understanding of the entity and its environment as well as the internal control processes and control environment relevant to the audit.

During the course of QAU visits, it was noted that in a number of situations, such considerations were not adequately performed and documented on file.

The issues raised at audit fieldwork stage are analysed as follows:

Analysis of File Findings Audit Fieldwork	Statutory Audit Firms (percentage) 2018	Statutory Auditors (percentage) 2018	Total Average (percentage) 2018	Total Average (percentage) 2017
Testing of loans and receivables	**100%**	**14%**	**45%**	39%
Testing of expenses	**25%**	**57%**	**45%**	23%
Testing of revenue	**25%**	**43%**	**36%**	42%
Testing of inventory	**25%**	**43%**	**36%**	35%

The analysis above indicates that testing of loans and receivables, expenses, revenue and the testing of inventory are notably the most common areas, at audit fieldwork stage, in which the QAU have found matters to be reported. These findings are very similar to those found in the prior year. It is of utmost importance that work carried out to address these areas is sufficiently and appropriately documented and adheres to the requirements emanating from relevant standards.

The below table denotes the most common pitfalls noted at audit completion stage of the files reviewed. This includes issues raised at audit reporting stage, broadly classified as report wording issues and the more serious issues relating to the audit opinion.

Analysis of File Findings Audit Completion and Reporting	Statutory Audit Firms (percentage) 2018	Statutory Auditors (percentage) 2018	Total Average (percentage) 2018	Total Average (percentage) 2017
Letter of representation	**50%**	**57%**	**55%**	68%
Audit report wording	**25%**	**57%**	**45%**	81%
Analytical procedures	**25%**	**57%**	**45%**	10%
Audit report issues	**50%**	**29%**	**36%**	55%
Subsequent events	**50%**	**29%**	**36%**	39%
Going concern	**25%**	**29%**	**27%**	26%

The most common issues raised at audit completion stage relate to the following areas:

Representations – Findings identified in respect to the content of the letter of representation continue to be prevalent on a number of QAU visits. The most common finding identified in respect to ISA 580 is that a number of representations as identified in the standard itself are not included in the letter of representation. Statutory auditors and audit firms are urged to assess whether their pro-forma letter of representation is fully in line with the requirements of ISA 580. The standard itself provides an illustrative letter of representation which may facilitate disclosure requirements, and practitioners and firms are advised to refer to the standard if they have not done so already.

Audit report wording – As in prior years, audit practitioners as well as firms are still not using appropriate audit report wording, in line with the relevant ISA requirements. Although there was an improvement in this regard when compared to prior years, there was still a 45% average rate of this weakness being noted on visits carried out.

During QAU visits, it was noted that:
- in some situations the Basis for Opinion and Management's Responsibility paragraph wording was not in line with the wording found in ISA 700;
- although an emphasis of matter paragraph was included in the audit report this did not satisfy all ISA 570 disclosure requirements; and
- an Other Information section was not included in a number of audit reports in line with ISA 720.

Statutory auditors and audit firms are requested to revisit ISA standards effecting the audit report wording and take steps to tailor their audit reports to adhere to those standards. The standards themselves contain proforma audit reports which will assist statutory auditors and audit firms in this regard.

Analytical procedures – During the year, there was a marked increase in the number of findings dealing with final analytical procedures. In particular, such findings were primarily noted in respect to sole practitioners providing audit services.

ISA 520 requires the engagement team to design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity. If fluctuations or relationships are inconsistent with this understanding or expectations by a significant amount, then the engagement team is required to investigate differences arising.

The QAU encountered a number of situations where the audit engagement team did not carry out final analytical procedures. Furthermore, on others although some analysis was carried out, it was noted that the engagement team did not investigate differences noted from expectations identified on the basis of the auditor's understanding of the client.

Audit report issues – There was a decrease in the number of audit report issues noted by the QAU during their visits. However, we still believe that more effort is needed to address these types of issues. Throughout the year, reviewers came across a number of situations where the audit evidence obtained and documented as well as conclusions found in the audit file did not sufficiently support the audit report found in the financial statements. In such situations, reviewers questioned the opinions given in the audit report.

Subsequent events – From QAU reviews during the year, it was noted that in a number of situations this standard was completely omitted from audit engagement files. Audit practitioners and audit firms are required to obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected. This considerations should be adequately documented in the audit file.

Issues raised at whole practice/firm level include issues in respect of ISQC 1, ACRs and cold file reviews, professional indemnity insurance and continuing professional education. The following is an analysis of such issues:

Analysis of Firm-Level Issues	Statutory Audit Firms (percentage) 2018	Statutory Auditors (percentage) 2018	Total Average (percentage) 2018	Total Average (percentage) 2017
Quality control issues	**75%**	**57%**	**64%**	68%
ACRs and cold file reviews	**-**	**71%**	**45%**	42%
Professional indemnity insurance	**50%**	**14%**	**27%**	19%
Continuing professional education	**25%**	**14%**	**18%**	16%

As part of all QAU visits, reviewers will look at the overall firm/practice -level controls in place, mainly arising from ISQC1 requirements as well as legislative requirements. The most common firm/practice level issues identified during visits were the following:

Quality control issues – Again this year, there was a slight improvement on the prior year in respect to findings noted in respect to quality control issues. Although we noted on one particular case, that the sole practitioner did not have policies and procedures in respect to ISQC 1 requirements, the rest of audit entities visited did have a quality control manual. However, reviewers noted that in many instances these policies and procedures did not fully address ISQC 1 requirements. Thus, it is recommended that practices and firms periodically revise their manual to ensure compliance with ISQC 1 requirements as well as tailor their policies and procedures manual to reflect what is actually being done within their practice.

ACRs and cold file reviews – In regard to ACRs and cold file reviews, although we found no issues with the audit firms visited, we found a number of instances where sole practitioners were not carrying out ACRs and cold file reviews in accordance with the guidance issued in this regard by the Accountancy Board.

6. Other Developments and Initiatives

Participation in International Fora

Throughout the year, the Accountancy Board has been actively involved in a number of meetings and committees abroad. Amongst others, the meetings that were attended during 2018 were in relation to:

- CEAOB Plenary
  During 2018, representatives and Members of the Board attended the CEAOB Plenary meetings during February and October in Brussels.

- CEAOB Inspections Sub-Group
  Two Inspections Sub-Group meetings were attended during the year. One was held in Porto, Portugal in June and the other was held in Vienna, Austria during November. Furthermore, the Head of the QAU and one of the reviewers attended the banking and insurance inspections workshop organized by the Inspections Sub-Group – Smaller Regulators Task Force in Berlin, Germany during October.

  Apart from this, the QAU is also involved in two Big 4 audit firm colleges, falling under the remit of the Inspections Sub-Group, for which we participated in a number of conference calls.

- CEAOB Market Monitoring Sub-Group
  During 2019, competent authorities within the EU will carry out the 2nd market monitoring exercise for submission to the EU Commission by mid-2019. The Market Monitoring Sub-Group was formed to assist member states in this regard and develop a consistent approach to be taken by competent authorities in Member States. The market monitoring exercise will provide the Commission with information on the market structure of the audit profession, market share held by the key players in the audit profession, information on audit committees as well as information in respect to quality assurance visits.

  During 2018, a member of the QAU participated in ten conference calls organized by the Market Monitoring Sub-Group. Furthermore, one meeting was attended by a Member of the Board in Brussels, during October.

- CEAOB Enforcement Sub-Group
  During the year, a representative from the Board attended one meeting in Paris during January 2018. Furthermore, a representative of the Board participated in seven conference calls during the year.

- Audit Regulatory Committee (AuRC)
  During December, a representative of the Board attended the Audit Regulatory Committee meeting.

- Accounting Regulatory Committee (ARC)
  During June and December, representatives of the Board attended Accounting Regulatory Committee meetings.

Co-operation with the Malta Institute of Accountants

Over the years, the Malta Institute of Accountants (MIA) and the Accountancy Board have fostered a close working relationship. This relationship has continued during 2018 with the MIA providing a number of services in relation to CPE.

Outlook for 2019

The Accountancy Board looks forward to the challenges ahead, particularly in relation to:

- The engagement of additional professional staff during 2019 within the QAU to strengthen the unit and ensure adequate resources are in place in respect to the inspections of audit practitioners/firms;
- The continuation of on-going co-operation with the MIA, MFSA and other competent authorities; and
- Attendance and participation in international fora.

Abbreviations

AB	Accountancy Board
ARC	Accounting Regulatory Committee
ACCA	Association of Chartered Certified Accountants
AuRC	Audit Regulatory Committee
CAIM	Common Audit Inspection Methodology
CPE	Continued Professional Education
CEAOB	Committee of European Auditing Oversight Bodies
EAIG	European Audit Inspections Group
ESMA	European Securities and Markets Authority
GAPSE	General Accounting Principles for Smaller Entities
GAPSME	General Accounting Principles for Small- and Medium-Sized Entities
IAASB	International Auditing and Accounting Standards Board
ICAEW	Institute of Chartered Accountants of England and Wales
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
ISAs	International Standards on Auditing
ISQC 1	International Standard on Quality Control
MIA	Malta Institute of Accountants
PIE	Public Interest Entity
QA	Quality Assurance
QAU	Quality Assurance Unit
SME	Small- and Medium-Sized Entities

SMP	Small & Medium Practices

Accountancy Board
Quality Assurance

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